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Economic substance in Jersey: Frequently asked questions

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Jersey is a popular place to establish an asset holding company because its corporate law is modern, flexible and modelled on English companies legislation.

Jersey introduced Taxation (Companies – Economic Substance) (Jersey) Law 2019 (the Substance Law) to require Jersey companies which carry on particular activities (called relevant activities) to have economic substance in Jersey.

This guide has some frequently asked questions or FAQs about the application of the Substance Law.

For a high-level overview of the economic substance requirements in each of our offshore jurisdictions (BVI, Cayman, Guernsey and Jersey), please view our fact sheet which is accessible from this page.

Why was the Substance Law introduced?

As a part of its base erosion and profit sharing (or BEPS) initiative, the European Union required offshore financial centre (OFCs) like Jersey to introduce legislation which seeks to ensure that an OFC does not facilitate structures that generate profits which do not reflect real economic activity in that OFC.

To avoid being placed on the European Union blacklist of non-compliant jurisdictions, Jersey introduced the Substance Law which came into force on 1 January 2019.

The Substance Law is supported by guidance (the Guidance) published by the Jersey Comptroller of Revenue (the Comptroller) which is periodically revised.

Where can I find the Substance Law and Guidance?

You can find a copy of the:

- Substance Law here; and
- Guidance here.

When does the Substance Law apply?

As explained in our other guides in this series, the Substance Law applies where a tax resident company:

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- carries on a relevant activity in a financial period; and
- earns gross income from that relevant activity.

What is a tax resident company?

A tax resident company is a company that is regarded as tax resident in Jersey under the Income Tax (Jersey) Law 1961 (the Tax Law).

Under the Tax Law:

- a Jersey company is regarded as tax resident in Jersey unless:
  - its business is centrally managed and controlled outside Jersey in a jurisdiction where the highest rate at which any company may be charged to tax on any part of its income is 10% or higher; and
  - the company is resident for tax purposes in that jurisdiction; and
- a foreign company is regarded as tax resident in Jersey if its business is managed and controlled in Jersey.

What are the relevant activities?

The relevant activities specified in the Substance Law are:

- banking business;
- distribution and service centre business (our guide on this relevant activity can be found here);
- fund management business (our guide on this relevant activity can be found here);
- finance and leasing business (our guide on this relevant activity can be found here);
- headquarters business (our guide on this relevant activity can be found here);
- holding company business (our guide on this relevant activity can be found here);
- intellectual property holding business;
- insurance business; and
- shipping business.

What is a financial period?

For the purposes of the Substance Law, a financial period is a period of up to 18 months for which a company's financial statements are prepared.

What are the economic substance requirements?

Where the Substance Law applies to a company, the company must satisfy the following economic substance requirements:

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- be directed and managed from Jersey;
- (having regard to the level activity carried on by it):
  - have an adequate number of employees physically present in Jersey (whether employed by it or by another person);
  - incur adequate expenditure in Jersey; and
  - have adequate physical assets in Jersey;
- carry on all of its core income generating activity (CIGAs) in Jersey; and
- (to the extent any of its CIGAs is carried out for it in Jersey by another person (like a corporate services provider)) be able to monitor and control in Jersey the carrying out of those CIGAs.

What is a core income generating activity or CIGA?

The essence of a CIGA is that it is a key essential and valuable activity that generates a company's income.

The Substance Law sets out CIGAs for each relevant activity. A company does not need to perform all of the CIGAs listed in the Substance Law for a relevant activity.

More information on the CIGA for:

- distribution and service centre business can be found here;
- fund management business can be found here;
- finance and leasing business can be found here;
- headquarters business can be found here; and
- holding company business can be found here.

What does adequate mean?

Although the Substance Law does not define what is meant by *adequate*, the Guidance states that it should be given its ordinary meaning of *enough or satisfactory for a particular purpose*.

The Guidance adds that:

- what is adequate for a company is dependent on the particular facts of the company and its level of business activity; and
- a company should keep appropriate records to demonstrate adequacy.

Are there any exemptions from the Substance Law?

The Substance Law will not apply to a company if in any financial period of the company it:

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- does not carry on any relevant activity;
- carries on a relevant activity but does not earn any gross income from it; or
- is not a tax resident company.

In addition, currently, the Substance Law does not apply to trusts, foundations or partnerships, however, the European Union requires the Substance Law to apply to partnerships by 1 July 2021.

Does the Substance Law apply to non-Jersey companies?

The Substance Law applies to any company that is tax resident in Jersey no matter where the company is incorporated. As mentioned above, under the Tax Law, a foreign company will be regarded as tax resident in Jersey if it its business is managed and controlled in Jersey.

Does the Substance Law apply to a company being liquidated?

The Guidance states that if a company in liquidation continues to carry on a relevant activity from which it earns gross income, it must satisfy the economic substance requirements for that relevant activity.

The Guidance adds that, since the powers of directors cease upon the appointment of a liquidator:

- the liquidator of the company will be required to demonstrate that the company is directed and managed in Jersey; and
- for the purposes of the directed and managed requirement, the liquidator is taken to be the board of directors.

What happens if a company carries on more than one relevant activity?

If a company carries on more than one relevant activity from which it earns gross income in a financial period, it must satisfy the economic substance requirements for each relevant activity during that financial period.

Does the Substance Law apply if a company only carries on a relevant activity for part of a financial period?

If a company only carries on a relevant activity from which it earns gross income for part of a financial period, it must nonetheless satisfy the economic substance requirements for that relevant activity during that financial period.

How is compliance with the economic substance requirements assessed?

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To allow the Comptroller to determine whether a company has satisfied the economic substance requirements for a relevant activity during a financial period, the company must file an annual tax return online.

The information which a company must provided in its tax return, includes:

- each relevant activity carried on by it;
- its gross income from each relevant activity;
- the operating expenditure incurred by it on each relevant activity;
- its CIGAs for each relevant activity;
- details of its premises in Jersey;
- the number of board meetings held at which a quorum was present in Jersey; and
- the number of its qualified employees in Jersey.

A tax return must be accompanied by a copy of the company's financial statements for the relevant financial period.

What happens if a company does not satisfy the economic substance requirements?

If a company fails to satisfy the economic substance requirements for any relevant activity carried on by it in a financial period, the Comptroller may impose a penalty of up to:

- £10,000 for the first financial period; and
- £100,000 for any subsequent financial period,

in which the company fails to satisfy those economic substance requirements.

If a company continues to fail to satisfy the economic substance requirements, it may lead to the company's name being struck off (or removed) from the register of companies kept by the Jersey registrar of companies.

About this guide

This guide gives a general overview of this topic. It is not legal advice and you may not rely on it. If you would like legal advice on this topic, please get in touch with one of the authors or your usual Collas Crill contacts.

About this series

This guide is part of our series *Let's talk about Jersey economic substance* which looks at aspects of Jersey's economic substance regime. The other guides in this series can be found in the Latest thinking section of our website.

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About Collas Crill

We are a leading offshore law firm. We are easy to do business with and give practical advice to overcome tough challenges. Through our network of offices, we practise British Virgin Islands, Cayman Islands, Guernsey and Jersey law.

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